

**CALIFORNIA INFRASTRUCTURE AND
ECONOMIC DEVELOPMENT BANK
(A Component Unit of the State of California)**

**FINANCIAL STATEMENTS
WITH
INDEPENDENT AUDITOR'S REPORT**

**YEAR ENDED
JUNE 30, 2004**

**CALIFORNIA INFRASTRUCTURE AND
ECONOMIC DEVELOPMENT BANK
(A Component Unit of the State of California)**

JUNE 30, 2004

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Gilbert Associates, Inc.
CPAs and Advisors

INDEPENDENT AUDITOR'S REPORT

**To the Members of the
California Infrastructure and Economic Development Bank
Sacramento, California**

We have audited the accompanying financial statements of the California Infrastructure and Economic Development Bank ("I-Bank"), a component unit of the State of California, as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the I-Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the of the I-Bank as of June 30, 2004, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 5 is not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Gilbert Associates, Inc.

GILBERT ASSOCIATES, INC.

June 23, 2005

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK MANAGEMENT'S DISCUSSION & ANALYSIS

Introduction

The following Management's Discussion & Analysis ("MD&A") provides an overview of the California Infrastructure and Economic Development Bank ("I-Bank"), a description of its activities and an analysis of the financial position of the California Infrastructure and Economic Development Bank Fund ("CIEDB Fund") and the California Infrastructure Guarantee Trust Fund ("Guarantee Trust Fund") for fiscal year ended June 30, 2004 (collectively, the CIEDB Fund and the Guarantee Trust Fund are the "Funds"). This is the first audited financial report for the I-Bank as required under a continuing disclosure agreement related to revenue bonds issued on March 18, 2004, which provided additional funding for the Infrastructure State Revolving Fund ("ISRF") Program. This audit covers the financial activities of the I-Bank and both its funds, and is slightly broader in scope than that required in the continuing disclosure agreement, which only required a report for the CIEDB Fund.

The information presented in this section should be read in conjunction with the financial statements and notes that follow this section.

History of the Infrastructure Bank and Current Programs

The I-Bank is a State of California ("State") financing authority that operates pursuant to the Bergeson-Peace Infrastructure and Economic Development Bank Act in Division 1 of Part 6.7 of the California Government Code (Section 63000 *et seq.*). The mission of the I-Bank is to finance public infrastructure and private development that promote economic growth, revitalize communities and enhance quality of life throughout California.

The I-Bank has broad statutory powers to issue revenue bonds and provide loans, lease financing and other forms of financing, including the provision of credit enhancements, for a wide variety of infrastructure and economic development projects. The I-Bank's current operations are funded solely from fees, interest earnings and ISRF Program (defined below) loan¹ repayments.

The I-Bank is governed by a Board of Directors ("Board") that as of the end of the fiscal year consisted of the Secretary of the Business, Transportation and Housing Agency, who serves as the chair, the Director of Finance and the State Treasurer. Shortly after the end of the fiscal year, the Secretary of the State and Consumer Services Agency and an appointee of the Governor were added to the Board. The Board is statutorily required to approve all financings undertaken by the I-Bank. The I-Bank's daily affairs are managed and conducted by the Executive Director appointed by the Governor and confirmed by the State Senate.

The I-Bank's major programs include the ISRF Program, which is a revolving loan program that provides low-cost financing to local government entities for sixteen categories of public infrastructure projects, and a variety of conduit revenue bond financing programs, including the Industrial Development Bond Program for manufacturing and processing companies, the 501(c)(3) Revenue Bond Program for nonprofit public benefit corporations and the Governmental Revenue Bond Program for governmental entities. Conduit bonds issued by the I-Bank are payable solely from the revenues generated by the underlying borrower, are neither backed nor guaranteed by either the State or the I-Bank, and do not involve the use of I-Bank funds.

¹ Loan is generically used to refer to loans, lease agreements and installment sale agreements.

Financial Highlights

- Total assets were \$358,569,536. Total liabilities were \$132,232,576. Assets exceeded liabilities by \$226,336,960.
- Operating revenues were \$6,886,498, operating expenses were \$4,229,723, resulting in \$2,656,775 in operating income.
- The statement of cash flows indicates cash flows from operating activities of \$4,995,969 and cash flows from investing activities of (\$54,079,870), which decreased cash and equivalents by \$49,083,901.
- The I-Bank issued \$51.37 million of Infrastructure State Revolving Fund Revenue Bonds on March 18, 2004, to provide additional funds for municipal infrastructure projects financed through the ISRF Program. The bonds were unenhanced, and rated “AA” by Fitch Ratings and Standard & Poor’s, and “Aa2” by Moody’s Investor’s Service.

Using this Annual Financial Report

The financial statements included in this annual financial report are those of the I-Bank. As discussed in Note 1, The Financial Reporting Entity, the basic financial statements herein are intended to present the financial position, change in financial position and cash flows of only the I-Bank. The financial statements do not purport to present the financial position of any other reporting entity.

Overview of Financial Statements

This MD&A is an introduction to the I-Bank financial statements and accompanying notes. The financial statements of the I-Bank are presented as a special purpose governmental entity engaged primarily in financing activities—providing loans to local governmental entities, providing revenue bond financing to private businesses, nonprofit entities, and other state and local governmental entities, as well as the authority to provide credit enhancements such as guarantees. The financial statements provide both short-term and long-term information about the Funds’ financial position with which the reader can assess the I-Bank’s fiscal condition as of the end of the fiscal year. The financial statements have been prepared using the accrual basis of accounting. The financial statements include the following three statements:

- The *Statement of Net Assets* presents information on the assets and liabilities of the Funds and the I-Bank, with the difference between the assets and the liabilities reported as net assets. Over time, increases or decreases in net assets are expected to serve as a useful indicator of whether the financial position of the Funds are improving or deteriorating.
- The *Statement of Revenues, Expenses and Changes in Net Assets* presents information reflecting how the net assets of the Funds and the I-Bank changed during the past year. All changes in the net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods.
- The *Statement of Cash Flows* reports the cash flows from operating activities, non-capital and financing activities and investing activities.

The *Notes to the Financial Statements* provide additional information that is essential to full understanding of the data provided in the financial statements. These notes can be found immediately following the financial statements.

Net Assets

The I-Bank net assets as of June 30, 2004, were \$226,336,960, all of which was restricted.

Table A-1

| | |
|---|----------------------|
| Current Assets | \$109,846,476 |
| Non-Current Assets | \$248,723,060 |
| Total Assets | \$358,569,536 |
| Current Liabilities | \$33,039,540 |
| Non-Current Liabilities | \$99,193,036 |
| Total Liabilities | \$132,232,576 |
| Net Assets--Restricted | \$226,336,960 |
| Total Liabilities and Net Assets | \$358,569,536 |

Changes in Net Assets

The I-Bank's operating income for the fiscal year ending June 30, 2004, was \$2,656,775.

Table A-2

| | |
|--------------------------------------|----------------------|
| Operating Revenues | \$6,886,498 |
| Operating Expenses | \$4,229,723 |
| Operating Income | \$2,656,775 |
| Change in Net Assets | \$2,656,775 |
| Net Assets, Beginning of year | \$223,680,185 |
| Net Assets, End of year | \$226,336,960 |

Budgetary Information

All I-Bank monies are continuously appropriated without regard to fiscal year to support the I-Bank with the exception of funds for general administration, which must annually be approved by the State Legislature. Continuous appropriation authority means that no further appropriations are necessary to expend funds held in the State Treasury. However, not all I-Bank money is held in the State Treasury. The bond trustee for the 2004 ISRF Bonds (defined below) holds money outside the State Treasury.

Debt Administration

The I-Bank administers the ISRF Program, which is a leveraged revolving loan program. The Board authorized the issuance of \$51.37 million in revenue bonds in March 2004 ("2004 ISRF Bonds"). Several existing ISRF Program loans that were funded from previous State General Fund appropriations were pledged to the repayment of the 2004 ISRF Bonds. The bonds were sold without a credit enhancement, and were rated "AA," "Aa2," and "AA" by Fitch Ratings, Moody's Investors Service and Standard & Poor's, respectively. The first 2004 ISRF Bonds principal payment will be due October 1, 2005. Proceeds of the 2004 ISRF Bonds are being used to fund new ISRF Program loans.

The I-Bank also issues industrial development bonds, 501(c)(3) bonds for nonprofit entities and bonds for other state and local governmental entities. During the fiscal year, the I-Bank served as the conduit issuer for \$1.48 billion of bonds. Conduit bonds are typically credit enhanced with letters of credit or bond insurance. Conduit bonds do not constitute a debt or liability of the State or of any political subdivision of the State, other than a limited obligation of the I-Bank payable solely from the pledged revenues of the conduit borrower, nor are a pledge of the faith and credit of the State or any political subdivision thereof, including the I-Bank. As such, the balance of outstanding conduit bonds is not reflected on the I-Bank's financial statements.

Economic Conditions and Outlook

In general, the State's economy and General Fund budget deficit did not have an impact on the Funds during the fiscal year since the I-Bank does not receive any on-going State General Fund support, and its programs continued to provide revenues sufficient to support operating expenses.

All ISRF Program loans were paid as agreed during the fiscal year, and continued timely repayment of all loans is expected. The ISRF Program continues to receive applications for financing. To ensure that sufficient funds are available for future ISRF Program borrowers, the I-Bank anticipates issuing a second series of revenue bonds for the ISRF Program in the 2005/2006 fiscal year.

Requests for Information

This financial report is designed to provide interested parties with a general overview of the finances of the I-Bank and the Funds. Questions concerning the information provided in this report or requests for additional information should be addressed to Stanton C. Hazelroth, Executive Director, California Infrastructure and Economic Development Bank, 1001 I Street, Sacramento, California 95814.

**CALIFORNIA INFRASTRUCTURE AND
ECONOMIC DEVELOPMENT BANK**

**STATEMENT OF NET ASSETS
JUNE 30, 2004**

| | California Infrastructure and Economic Development Bank Fund | California Infrastructure Guarantee Trust Fund | Total |
|---|--|--|-----------------------|
| ASSETS | | | |
| CURRENT ASSETS | | | |
| Cash and equivalents | \$ 85,082,294 | \$ 20,184,000 | \$ 105,266,294 |
| Pledged loans receivable - disbursed | 2,431,664 | | 2,431,664 |
| Non-pledged loans receivable | 98,562 | | 98,562 |
| Interest and other receivables | 1,977,659 | 72,297 | 2,049,956 |
| Total current assets | <u>89,590,179</u> | <u>20,256,297</u> | <u>109,846,476</u> |
| NON-CURRENT ASSETS | | | |
| Pledged loans receivable - disbursed | 96,848,071 | | 96,848,071 |
| Pledged loans receivable - undisbursed | 73,447,184 | | 73,447,184 |
| Non-pledged loans receivable | 23,409,379 | | 23,409,379 |
| Investments - restricted | 54,079,870 | | 54,079,870 |
| Unamortized bond issuance costs | 938,556 | | 938,556 |
| Total non-current assets | <u>248,723,060</u> | | <u>248,723,060</u> |
| TOTAL ASSETS | <u>\$ 338,313,239</u> | <u>\$ 20,256,297</u> | <u>\$ 358,569,536</u> |
| LIABILITIES AND NET ASSETS | | | |
| CURRENT LIABILITIES | | | |
| Accounts payable | \$ 1,835,905 | | \$ 1,835,905 |
| Undisbursed pledged loan commitments | 29,002,977 | | 29,002,977 |
| Bond interest payable | 747,830 | | 747,830 |
| Deferred loan origination fees | 1,452,828 | | 1,452,828 |
| Total current liabilities | <u>33,039,540</u> | | <u>33,039,540</u> |
| NON-CURRENT LIABILITIES | | | |
| Undisbursed pledged loan commitments | 44,444,207 | | 44,444,207 |
| Deferred interest income | 350,000 | | 350,000 |
| Revenue bonds payable | 54,398,829 | | 54,398,829 |
| Total non-current liabilities | <u>99,193,036</u> | | <u>99,193,036</u> |
| Total liabilities | <u>132,232,576</u> | | <u>132,232,576</u> |
| NET ASSETS | | | |
| Restricted - Expendable: | | | |
| Statute | <u>206,080,663</u> | <u>\$ 20,256,297</u> | <u>226,336,960</u> |
| TOTAL NET ASSETS | <u>206,080,663</u> | <u>20,256,297</u> | <u>226,336,960</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 338,313,239</u> | <u>\$ 20,256,297</u> | <u>\$ 358,569,536</u> |

**CALIFORNIA INFRASTRUCTURE AND
ECONOMIC DEVELOPMENT BANK**

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2004**

| | California Infrastructure and Economic Development Bank Fund | California Infrastructure Guarantee Trust Fund | Total |
|--------------------------------------|--|--|-----------------------|
| OPERATING REVENUES | | | |
| Interest on loan repayments | \$ 4,245,523 | | \$ 4,245,523 |
| Investment income | 1,597,067 | \$ 256,297 | 1,853,364 |
| Administration fee revenue | <u>787,611</u> | <u></u> | <u>787,611</u> |
| Total operating revenues | <u>6,630,201</u> | <u>256,297</u> | <u>6,886,498</u> |
| OPERATING EXPENSES | | | |
| Program support | 3,465,933 | | 3,465,933 |
| Interest on bond debt | 676,760 | | 676,760 |
| Agency administration | 56,901 | | 56,901 |
| Amortization of bond issuance costs | 19,745 | | 19,745 |
| Miscellaneous expense | <u>10,384</u> | <u></u> | <u>10,384</u> |
| Total operating expenses | <u>4,229,723</u> | <u></u> | <u>4,229,723</u> |
| OPERATING INCOME | <u>2,400,478</u> | <u>256,297</u> | <u>2,656,775</u> |
| TRANSFERS | | | |
| Interfund transfers | <u>(20,000,000)</u> | <u>20,000,000</u> | <u></u> |
| CHANGE IN NET ASSETS | <u>(17,599,522)</u> | <u>20,256,297</u> | <u>2,656,775</u> |
| NET ASSETS, Beginning of year | <u>223,680,185</u> | <u></u> | <u>223,680,185</u> |
| NET ASSETS, End of year | <u>\$ 206,080,663</u> | <u>\$ 20,256,297</u> | <u>\$ 226,336,960</u> |

**CALIFORNIA INFRASTRUCTURE AND
ECONOMIC DEVELOPMENT BANK**

**STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2004**

| | California Infrastructure and Economic Development Bank Fund | California Infrastructure Guarantee Trust Fund | Total |
|---|--|--|-----------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Cash received from investments | \$ 2,254,695 | \$ 184,000 | \$ 2,438,695 |
| Cash received from interest on loan repayments | 5,481,492 | | 5,481,492 |
| Cash received from administration fees | 1,106,180 | | 1,106,180 |
| Receipt of revenue bond proceeds | 51,370,000 | | 51,370,000 |
| Receipt of bond premiums | 3,099,899 | | 3,099,899 |
| Receipt of loan repayments | 1,474,824 | | 1,474,824 |
| Payment of bond issuance costs | (958,301) | | (958,301) |
| Payment of outstanding loan commitments | (46,276,967) | | (46,276,967) |
| Payment of administrative expenses | (3,120,705) | | (3,120,705) |
| Reimbursement to TTCA/BTH pooled cash account | (9,619,148) | | (9,619,148) |
| Net cash provided by operating activities | <u>4,811,969</u> | <u>184,000</u> | <u>4,995,969</u> |
| CASH FLOWS FROM NON-CAPITAL AND FINANCING ACTIVITIES: | | | |
| Transfers to/from other funds | (20,000,000) | 20,000,000 | |
| Net cash (used) provided by non-capital and financing activities: | <u>(20,000,000)</u> | <u>20,000,000</u> | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchase of investments | (54,079,870) | | (54,079,870) |
| Net cash used in investing activities | <u>(54,079,870)</u> | | <u>(54,079,870)</u> |
| NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS | (69,267,901) | 20,184,000 | (49,083,901) |
| CASH AND EQUIVALENTS, June 30, 2003 | <u>154,350,195</u> | | <u>154,350,195</u> |
| CASH AND EQUIVALENTS, June 30, 2004 | <u>\$ 85,082,294</u> | <u>\$ 20,184,000</u> | <u>\$ 105,266,294</u> |
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | | |
| Operating income | \$ 2,400,478 | \$ 256,297 | \$ 2,656,775 |
| Adjustments to reconcile to net cash provided by operating activities: | | | |
| Amortization of bond issuance costs | 19,745 | | 19,745 |
| Amortization of bond premium | (71,070) | | (71,070) |
| Changes in assets and liabilities: | | | |
| Other receivables | 1,598,021 | (72,297) | 1,525,724 |
| Loans receivable | (44,802,143) | | (44,802,143) |
| Bond interest payable | 747,830 | | 747,830 |
| Bond issuance costs | (958,301) | | (958,301) |
| Accounts payable | (9,206,635) | | (9,206,635) |
| Revenue Bonds Payable | 54,469,899 | | 54,469,899 |
| Deferred loan origination | 264,145 | | 264,145 |
| Deferred interest income | <u>350,000</u> | | <u>350,000</u> |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>\$ 4,811,969</u> | <u>\$ 184,000</u> | <u>\$ 4,995,969</u> |

**CALIFORNIA INFRASTRUCTURE AND
ECONOMIC DEVELOPMENT BANK
(A Component Unit of the State of California)**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

1. THE FINANCIAL REPORTING ENTITY

The California Infrastructure and Economic Development Bank (“I-Bank”), a component unit of the State of California (“State”), is a public instrumentality of the State, organized and existing pursuant to the Bergeson-Peace Infrastructure and Economic Development Bank Act, constituting Division 1 of Title 6.7 of the California Government Code commencing with Section 63000 (“Act”). The I-Bank has broad powers to provide financing for a wide array of infrastructure and economic development projects. The general mission of the I-Bank is to finance public infrastructure and private development that promote economic growth, revitalize communities and enhance the quality of life throughout California.

Through December 31, 2003, the I-Bank existed within the State’s Technology, Trade and Commerce Agency (“TTCA”) and was governed by a three member Board of Directors (“Board”) consisting of the Secretary of TTCA, the State Treasurer and the Director of the Department of Finance. Chapter 229, Statutes of 2003 (“AB 1757”) abolished TTCA effective December 31, 2003, and moved the I-Bank to the State’s Business, Transportation and Housing Agency (“BTH”). AB 1757 did not provide a replacement member for the Secretary of TTCA and the Board operated with two members until June 18, 2004, when the Secretary of BTH was added to the Board as the chair by Chapter 48, Statutes of 2004. Shortly thereafter, the Secretary of the State and Consumer Services Agency and an appointee of the Governor were added to the Board by Chapter 227, Statutes of 2004.

The Infrastructure State Revolving Fund Revenue Bonds, Series 2004 (“2004 ISRF Bonds”) were issued by the I-Bank pursuant to a Series Indenture, dated as of March 1, 2004 (“2004 Series Indenture”) and a Master Indenture, dated as of March 1, 2004 (“Master Indenture”). The 2004 ISRF Bonds were issued in order to enable the I-Bank to continue providing low-cost financing to local government entities for infrastructure projects pursuant to the Infrastructure State Revolving Fund Program (“ISRF Program”), to fund a reserve fund and to pay costs of issuance. Eligible ISRF Program borrowers include cities, counties, redevelopment agencies, special districts, assessment districts, joint powers authorities and non-profit corporations formed by local government entities. The 2004 ISRF Bonds are secured by a pledge of specified collateral (“2004 Collateral”) under the 2004 Series Indenture.

In addition to the ISRF Program described above, the I-Bank serves as a conduit issuer of revenue bonds, loans, and commercial paper for private, nonprofit and other governmental entities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION /FUND FINANCIAL STATEMENTS

The basic financial statements of the I-Bank include the financial activities of the California Infrastructure and Economic Development Bank Fund (“CIEDB Fund”) and the California Infrastructure Guarantee Trust Fund (“Guarantee Trust Fund”) (collectively, the CIEDB Fund and the Guarantee Trust Fund are “Funds”). Moneys in the Funds are held within the California State Treasury or by the bond trustee for the 2004 ISRF Bonds (“Trustee”).

**CALIFORNIA INFRASTRUCTURE AND
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NOTES TO THE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

CIEDB Fund – The CIEDB Fund is continuously appropriated without regard to fiscal years for the support of the I-Bank and is available for expenditure for the purposes stated in the Act. However, moneys in the CIEDB Fund are available for expenditure for general administration only upon appropriation by the State Legislature. The CIEDB Fund is an enterprise fund.

Guarantee Trust Fund – The Guarantee Trust Fund is continuously appropriated to the I-Bank without regard to fiscal year for the purpose of guaranteeing all or a portion of the accounts and sub accounts within the CIEDB Fund, any contracts or obligations of the I-Bank or a sponsor, as that term is defined in the Act, and all or a part of any series of bonds issued by the I-Bank, by a special purpose trust, or by a sponsor. Funds may be transferred between the CIEDB Fund and the Guarantee Trust Fund when appropriate to accomplish the financing objectives of the I-Bank. The Guarantee Trust Fund is an enterprise fund.

B. ACCOUNTING PRINCIPLES

The accompanying financial statements have been prepared using the economic resources measurement focus and accrual basis of accounting in accordance with generally accepted accounting principles. The Funds are maintained by the I-Bank in accordance with the principles of fund accounting. The I-Bank management has elected under Government Accounting Standards Board (“GASB”) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting* to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (“FASB”) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The I-Bank management has elected the option, under GASB Statement No. 20, not to apply all FASB Statements and Interpretations issued after November 30, 1989.

The primary operating revenue of the I-Bank is financing income, representing interest on indebtedness received from borrowers. The I-Bank also recognizes as operating revenue the income on investments and fees charged to ISRF Program borrowers and conduit bond borrowers. Operating expenses primarily include interest expense on the 2004 ISRF Bonds and program support expenses.

C. CASH FLOW PRESENTATION

The statement of cash flows is provided in accordance with the provisions of GASB Statement No. 9 (“GASB 9”), *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34 (“GASB 34”), *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. In accordance with GASB 9 and GASB 34, the direct method was used to report net cash flows from operating activities.

**CALIFORNIA INFRASTRUCTURE AND
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NOTES TO THE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

D. CASH, CASH EQUIVALENTS AND INVESTMENTS

The I-Bank considers all short-term investments with an original maturity of three months or less to be cash equivalents. Cash and investments held in either the State's Surplus Money Investment Fund ("SMIF") or money market funds held by the Trustee are considered to be highly liquid and cash equivalents.

E. LOANS RECEIVABLE

The I-Bank enters into loan agreements, installment sale agreements and lease agreements ("Loans") for the purpose of financing public infrastructure pursuant to the ISRF Program. Loans Receivable includes pledged and non-pledged loans. Pledged Loans Receivable consists of two components – the disbursed and the undisbursed amount of ISRF Program Loans. The disbursed amount includes amounts drawn by the borrower for reimbursement or payment of project costs and the undisbursed amount includes the balance available to be drawn by the borrowers and draws submitted for payment but unpaid at year end. The undisbursed amount is offset by a liability for Outstanding Undisbursed Loan Commitments. Non-pledged Loans Receivable includes only disbursed amount drawn by the borrower for reimbursement or payment of project costs, and does not include the balance available to be drawn by the borrower.

Prior to the issuance of the 2004 ISRF Bonds, ISRF Program Loans were funded solely by General Fund appropriations received from the State, ISRF Program Loan repayments, fee revenue and investment income. Certain of these ISRF Program Loans are 2004 Pledged Loans since these Loans were pledged to the repayment of the 2004 ISRF Bonds under either the 2004 Series Indenture or Master Indenture and are reported as Pledged Loans Receivable on the statement of net assets.

As of March 18, 2004, borrowers with an ISRF Program Loans pledged to either the 2004 Series Indenture or Master Indenture became responsible for making principal and interest payments directly to the Trustee pursuant to their amortization schedule regardless of the amount disbursed. For borrowers with undisbursed amounts, a portion of the borrower's interest payments is offset by credits given to the borrower for actual interest earned by the I-Bank on undisbursed funds at a rate not to exceed the stated rate of interest on the borrower's ISRF Program Loan. The I-Bank transfers the interest credit on behalf of the borrower such that the amounts received by the Trustee from both the borrower and the I-Bank equal the scheduled interest payment amounts due pursuant to the borrower's amortization schedule.

ISRF Program Loans in existence prior to March 18, 2004, and not pledged to either the 2004 Series Indenture or the Master Indenture as of the end of the fiscal year were charged interest only on disbursed funds and do not receive a credit for interest earned on undisbursed funds.

**CALIFORNIA INFRASTRUCTURE AND
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(A Component Unit of the State of California)**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Generally, the first principal payment on an ISRF Program Loan is due at or around the expected project construction completion date, which is typically two to three years after the loan approval date. ISRF Program borrowers who enter into leases with the I-Bank in which the asset that is being constructed is the subject of the lease are prohibited from making repayments until they have effective use and occupancy of the leased asset, typically less than three years after the loan approval date. In such cases, the I-Bank capitalizes interest in the financing amount to pay the construction period semi-annual interest payments due during the construction period. There is no provision for uncollectible accounts as all ISRF Program Loans are current, and management believes all ISRF Program Loans will be repaid according to the scheduled terms.

F. RESTRICTED INVESTMENTS

Investments are recorded at fair value or contract value (or cost) for non-participating guaranteed investment contracts. Where applicable, fair values are based upon market quotes from national security exchanges. Under guaranteed investment contracts for certain accounts associated with the 2004 ISRF Bonds ("2004 ISRF Guaranteed Investment Agreements"), the I-Bank has invested monies with a financial services company ("Investment Provider") at a fixed contract rate of interest. Because the 2004 ISRF Guaranteed Investment Agreements are a contractual agreement, there is no rating available for such an instrument, although at the time the 2004 ISRF Guaranteed Investment Agreements were entered into, the Investment Provider provided a guarantee from its corporate parent ("Guarantor"), the senior long-term debt of which was rated in the highest rating category by three nationally recognized rating organizations.

The 2004 ISRF Guaranteed Investment Agreements are collateralized by securities held by a collateral agent and registered in the name of the Trustee. Collateral levels must be at least 104% of the principal and accrued but unpaid interest on the investments under the 2004 ISRF Guaranteed Investment Agreements for bonds or interest-bearing notes or obligations of the United States, or obligations of the Government National Mortgage Association, solely to the extent the faith and credit of the United States are pledged for the payment of principal and interest. Collateral levels must be at least 105% of the principal and accrued but unpaid interest on the investments under the 2004 ISRF Guaranteed Investment Agreements for any other eligible collateral. The collateral is valued on a weekly basis. In the event that the long-term unsecured, unsubordinated debt obligations of the Guarantor are at any time rated below "AA" in the case of Standard & Poor's ("S&P") or "Aa2" in the case of Moody's Investors Service ("Moody's"), the Investment Provider is required to (unless waived by the Trustee upon instructions from the I-Bank): (1) assign its rights and obligations to another entity rated at least "AA" in the case of S&P, or "Aa2" in the case of Moody's, which shall assume all liabilities of the Investment Provider; (2) obtain a guaranty of its obligations under the 2004 ISRF Guaranteed Investment Agreements from another entity rated at least "AA" in the case of S&P, or "Aa2" in the case of Moody's, or (3) repay the principal of and accrued but unpaid interest on the investments, together with an agreed upon termination amount.

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Under the terms of the 2004 Series Indenture and the Master Indenture, separate restricted accounts were established with the Trustee. The accounts and their purpose follow:

Revenue Fund – Repayments from loans pledged to the 2004 Series Indenture as well any amounts transferred from the Master Indenture and all interest, profits and other income received from the investment of moneys held in the funds or accounts established under the 2004 Series Indenture, except the Rebate account are deposited into the 2004 Revenue Fund.

Debt Service Account – Amounts in the 2004 Debt Service Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest, principal and mandatory sinking account payments on the 2004 ISRF Bonds when due and payable (including accrued interest on any 2004 ISRF Bonds purchased or redeemed prior to maturity).

Reserve Account – Amounts in the 2004 Reserve Account are used and withdrawn by the Trustee solely for the purpose of curing any deficiency in the 2004 Debt Service Account for the payment or redemption of all 2004 ISRF Bonds outstanding.

Administrative Expense Account – Amounts in the 2004 Administrative Expense Account are used to pay administrative expenses of the I-Bank associated with the 2004 ISRF Bonds as they become due and payable.

Cost of Issuance Account – Amounts in the 2004 Costs of Issuance Account were used by the I-Bank to pay the associated costs of issuing the 2004 ISRF Bonds.

Obligation Account – The net proceeds of the 2004 ISRF Bonds were deposited into the 2004 Obligation Account. At such time as the Trustee receives instructions from the I-Bank stating that an ISRF Program Loan has been fully executed by a borrower, the Trustee shall transfer the amount of such ISRF Program Loan from the 2004 Obligation Account to a separate borrower subaccount (“Obligation Subaccount”) that the Trustee shall establish and maintain within the 2004 Obligation Account. Moneys on deposit in each borrower’s Obligation Subaccount will be disbursed to the borrower upon receipt by the Trustee of a requisition from the I-Bank.

Cross Collateral Account – Amounts in the Cross Collateral Account consist of Master Indenture Revenues received by the Trustee. Master Indenture Revenues include repayments from Loans pledged to the Master Indenture, transfers from each series indenture issued under the Master Indenture, and all interest, profits and other income received from the investment of moneys held in accounts established under the Master Indenture. Amounts held in the Cross Collateral Account are available to cure a deficiency or a cumulative deficiency with respect to any bonds secured by the Master Indenture, including the 2004 ISRF Bonds.

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Equity Account – Two days after any April 1 and October 1 (the debt service payment dates on all series of bonds issued under the Master Indenture), the Trustee shall transfer the balance of the amounts on deposit in the Cross Collateral Account to the Equity Account. Amounts on deposit in the Equity Account shall be held therein by the Trustee until the Trustee receives instructions from the I-Bank to transfer the requested amounts to the centralized treasury system for any lawful purpose of the I-Bank. To the extent there are amounts on deposit in the Equity Account and there are insufficient funds to pay debt service on the 2004 ISRF Bonds, or any other series of bonds issued under the Master Indenture, the Trustee shall use such amounts to cure a deficiency or a cumulative deficiency with respect to any bonds secured by the Master Indenture.

G. ISSUANCE COSTS

Costs associated with the issuance of the 2004 ISRF Bonds included bond counsel fees, trustee fees, rating agency fees, underwriting costs, financial advisor fees and other miscellaneous expenses. Bond issuance costs are amortized using the straight-line method over the term of the 2004 ISRF Bonds.

H. REVENUE BONDS PAYABLE

Revenue bonds payable are stated at their unpaid balance plus or minus any remaining unamortized premiums or discounts. Bond premium and discounts are amortized using the effective-interest method over the terms of the 2004 ISRF Bonds.

I. LOAN AND CONDUIT BOND FEES

The I-Bank charges an origination fee and an annual servicing fee to ISRF Program borrowers. The origination fee is due no later than the date of the borrower's first disbursement and reported as deferred revenue when billed. The origination fee is recognized as revenue on a straight line basis over the life of the corresponding loan. The annual servicing fee is recognized as income when charged. The I-Bank also charges an application, bond issuance and an annual fee to entities for which it serves as the conduit issuer of bonds. Conduit bond fees are recognized as revenue when charged.

J. BONDS PAYABLE

The 2004 ISRF Bonds are subject to mandatory and optional redemption prior to their stated maturity. The 2004 ISRF Bonds are not obligations of the State, and the taxing power of the State is not pledged for their payments. The obligation of the I-Bank to make such payments is a limited obligation, payable solely from the 2004 Collateral pledged by the I-Bank.

K. INVESTMENT INCOME

Investment income is considered operating revenue because the 2004 ISRF Bonds were issued for the purpose of financing infrastructure projects. A portion of this financing comes from

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investment earnings.

L. CLASSIFICATION OF NET ASSETS

Restricted net assets represent amounts restricted due to external restrictions imposed by creditors, laws or regulations of the government, and restrictions imposed by law through constitutional provisions or enabling legislation, or for programs established by the I-Bank.

All of the I-Bank's net assets are restricted by statute for programs established by the I-Bank and for programs administered pursuant to the Act.

M. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the reporting date and revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. CASH AND EQUIVALENT

Cash and equivalents at June 30, 2004 were as follows:

| | |
|---|-----------------------|
| Deposits in Money Market Accounts | \$ 403,290 |
| Deposits in Surplus Money Investment Fund | <u>104,863,004</u> |
| Total cash and equivalents | <u>\$ 105,266,294</u> |

Because of the limited nature of the I-Bank's activities as established in the Act, all cash and equivalents are considered restricted at June 30, 2004 since these funds cannot be spent for any purpose other than as established in the Act.

The I-Bank has invested excess cash funds held within the State's centralized treasury system in SMIF. All of the resources of SMIF are invested through the Pooled Money Investment Account ("PMIA"). The PMIA investment program is designated by the Pooled Money Investment Board and is administered by the Office of the State Treasurer ("Treasurer"). Investments in SMIF are stated at fair value.

Additional disclosure details required by GASB Statement No. 3 and GASB Technical Bulletin 94-1, regarding cash deposits, investments, and derivatives, can be found in the June 30, 2004 Comprehensive Annual Financial Report of the State.

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4. INVESTMENTS

The I-Bank may, from time to time, direct the Treasurer to invest moneys in the CIEDB Fund and Guarantee Trust Fund held within the State's centralized treasury system that are not required for its current needs, including proceeds from the sale of any bonds, in any eligible securities specified in Government Code Section 16430 as the I-Bank shall designate. The I-Bank may direct the Treasurer to deposit moneys in interest-bearing accounts in any bank in the State or in any savings and loan association in the State. The I-Bank may alternatively require the transfer of moneys in the Funds to the SMIF for investment.

Government Code Section 5922(d) provides that bond proceeds and moneys set aside and pledged to the repayment of bonds may be invested in securities or obligations described in the indenture for those bonds. Moneys held by the Trustee in each of the funds and accounts under the 2004 Series Indenture and Master Indenture shall be invested and reinvested by the Trustee in permitted investments, as that term is defined in the 2004 Series Indenture, which mature or are subject to redemption by the owner thereof prior to the date such funds are expected to be needed.

The I-Bank reports investments at fair value or cost which is the contract value for non-participating guaranteed investment agreements. The I-Bank's investments in the 2004 ISRF Guaranteed Investment Agreements are backed by collateral held by the collateral agent.

As of June 30, 2004, the I-Bank had the following investments related to the 2004 ISRF Bonds:

| <u>Uncategorized Investments</u> | <u>Maturities</u> | <u>Contract Value</u> |
|---|-------------------|---------------------------|
| 2004 ISRF Guaranteed Investment Agreements: | | |
| 2004 Obligation Account | March 18, 2007 | \$ 49,975,000 |
| 2004 Reserve Account | October 1, 2032 | 3,534,443 |
| 2004 Debt Service and Revenue Accounts | October 1, 2032 | <u>570,427</u> |
| | | <u>\$ 54,079,870</u> |

The Investment Provider for the 2004 ISRF Guaranteed Investment Agreements was AIG Matched Funding Corp. and the Guarantor was American International Group, Inc. The Guarantor was rated "AAA", "Aaa" and "AAA" by S&P, Moody's and Fitch, respectively, as of June 30, 2004.

Interest on the 2004 ISRF Guaranteed Investment Agreements is paid semi-annually at interest rates ranging from 2.91% to 4.65%.

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5. PLEDGED LOANS RECEIVABLE

Pledged loans receivable consist of the 2004 Pledged Loans (i.e. those ISRF Program Loans, that were pledged to the 2004 Series Indenture and the Master Indenture by the I-Bank). The I-Bank agreed to make payments to the Trustee in amounts and at times sufficient to repay the 2004 ISRF Bonds as they become due. The I-Bank originally pledged ISRF Program Loans totaling \$78,667,398 to the 2004 ISRF Bonds under the 2004 Series Indenture, and \$88,133,010 under the Master Indenture. The principal and interest received during the fiscal year from these 2004 Pledged Loans is used to make the semi-annual debt service payments on the 2004 ISRF Bonds.

6. BONDS PAYABLE

The following is a summary of bonds payable at June 30, 2004:

| | |
|---|----------------------|
| Infrastructure State Revolving Fund Revenue Bonds, Series 2004, bearing 2.00% to 5.00% interest payable semi-annually, final maturity October 1, 2032 | \$ 51,370,000 |
| Plus: Unamortized Premiums | <u>3,028,829</u> |
| Net Bonds Payable | <u>\$ 54,398,829</u> |

The following is a schedule of the debt service requirements as of June 30, 2004:

| Year Ending June 30, | Principal | Interest | Total Debt Service |
|-------------------------|--------------------------------|----------------------|-----------------------|
| 2005 | | \$ 2,356,607 | \$ 2,356,607 |
| 2006 | \$ 1,145,000 | 2,245,168 | 3,390,168 |
| 2007 | 1,295,000 | 2,220,018 | 3,515,018 |
| 2008 | 1,315,000 | 2,193,818 | 3,508,818 |
| 2009 | 1,340,000 | 2,162,118 | 3,502,118 |
| 2010-2014 | 7,350,000 | 9,974,431 | 17,324,431 |
| 2015-2019 | 8,685,000 | 8,268,729 | 16,953,729 |
| 2020-2024 | 10,070,000 | 5,981,125 | 16,051,125 |
| 2025-2029 | 11,825,000 ⁽¹⁾ | 3,258,813 | 15,083,813 |
| 2030-2033 | <u>8,345,000⁽²⁾</u> | <u>494,300</u> | <u>8,839,300</u> |
| Total | <u>\$ 51,370,000</u> | <u>\$ 39,155,127</u> | <u>\$ 90,525,127</u> |

⁽¹⁾ Principal payments in the amount of \$9,670,000 are made from sinking fund payments for the 2029 term bonds.

⁽²⁾ Principal payments in the amount of \$8,345,000 are made from sinking fund payments for the 2032 term bonds.

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Bond activity for the year ended June 30, 2004 was as follows:

| | Balance at Inception | Issued | Redeemed | Balance June 30, 2004 |
|-----------------|-------------------------|----------------------|----------|--------------------------|
| 2004 ISRF Bonds | \$ _____ | \$ <u>51,370,000</u> | \$ _____ | \$ <u>51,370,000</u> |

7. CONDUIT DEBT OBLIGATIONS

The I-Bank has served as the conduit issuer for over 100 bond issues for private, nonprofit and governmental entities. As of June 30, 2004, the aggregate outstanding amount of all conduit bond issues was approximately \$3.4 billion, including bonds issued by the former California Economic Development Financing Authority, which were assumed by the I-Bank pursuant to Chapter 4, Statutes of 1998, and excluding the amount of conduit bonds that were issued by special purpose trusts created by the I-Bank. These conduit bonds do not constitute a debt or liability of the State or of any political subdivision of the State, other than a limited obligation of the I-Bank payable solely from the pledged revenues of the conduit borrower, nor a pledge of the faith and credit of the State or any political subdivision thereof. As such, the balance of outstanding conduit bonds is not reflected on the I-Bank's financial statements.

8. COMMITMENTS AND CONTINGENCIES

In June 2003, the I-Bank approved a preliminary loan guarantee commitment for the Imperial Irrigation District ("IID") related to the potential future issuance of revenue bonds by IID, which may finance a water supply project consisting of water conservation measures needed to implement the IID and the San Diego County Water Authority ("SDCWA") 45-year water conservation and transfer agreement ("Transfer Agreement") for the transfer of up to 200,000 acre-feet per year of water supply to the SDCWA based upon IID water conservation measures. Subsequently, the IID, the SDCWA, the Metropolitan Water District of Southern California and the Coachella Valley Water District negotiated terms of a Quantification Settlement Agreement, which includes a series of agreements regarding the settlement of disputes among the parties arising from the Transfer Agreement and ensures that the State continues to receive the maximum amount of water from the Colorado River. During the fiscal year, the I-Bank transferred \$20 million from the CIEDB Fund to the Guarantee Trust Fund in conjunction with the preliminary loan guarantee commitment for the IID. The preliminary loan guarantee commitment shall expire December 31, 2009, unless extended in writing by the Board.